LOS ANGELES BAR BULLETIN

In This Issue

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VOL. 35 NOVEMBER, 1959 No. 1

The President's Page

THE HIGH COST OF LAW

HUGH W. DARLING

One of the panel discussions at the State Bar Convention last September was concerned with the high and mounting cost of litigation. Governor Brown rightly warned us that "justice costs too much." The subject was relevant and timely, but the panel should have included the entire area of law as the high cost is not limited to litigation.

As a preface, it might be well to record that the necessary cost of providing and administering justice under law, whatever that cost may be, is not too dear a price to pay. Without it life could be intolerable, and to those of us who are privileged to live under a democracy it would be. But the fact that unshackled justice is worth anything we have to pay for it does not mean that appropriate cost controls should not be applied. Nor does it mean that lawyers are in no danger of pricing themselves out of the field in the non-litigious area of law, which embraces a major territory of legal practice.

It is not so much the increase in the per hour rates a lawyer must charge today contrasted with going rates a century past, but rather the number of hours spent on client problems. After he was fully seasoned and well established, Abraham Lincoln averaged around $1,500.00 a year with fees ranging from $2.50 to $50.00, and by the time he went to Washington his

accumulated fortune totaled $15,000.00. The chances are, though, that it would take at least twenty of our dollars to buy what one of his dollars would buy in those days. Moreover, Lincoln was able to tote his law library in a saddlebag whereas now simply to maintain a minimum library costs close to $6,000.00 a year, including space rent. Thus current hourly rates, scaling from a subnormal low of $10.00 to an abnormal high of $100.00, are not disproportionate, relatively speaking, to the tariffs of yore. We are not being overpaid from a rate standpoint.

Still the cost of law is off course, so the blame must be charged in some part to the expenditure of too much time in the accomplishment of our tasks. There are not many contracts in circulation that could not be condensed by at least 10% without impairing their validity or coverage, and there are some that could stand a 50% shrinkage to advantage. Thus in theory, and not too far from fact, the cost of out of Court legal work could be reduced as much as 50%, assuming that it takes only

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Issue Editor—David I. Lippert

COURT CONGESTION
Is Settlement the Key?

By LOUIS M. BROWN*

LOUIS M. BROWN

There is currently a great deal of time, thought, and attention being given to the mounting jam of litigation. There is here offered a suggestion which may help cure the litigious onslaught.

There are, no doubt, various ways to attack the problem. The avenue of attack here considered is the settlement process.

Every time a claim is settled, court congestion is curtailed. No doubt, in all the current discussion about court congestion not enough credit is given to the great number of settlements made by members of the Bar. The effect of a settlement is certainly to lessen court congestion. This is true no matter at what stage an out-of-court settlement is reached. Obviously, from the point of court congestion, a settlement made before suit is better than one made after court procedures are used.

Efforts made to settle may take lawyers' time but, absent the use of court processes, take none of the court's time. Settlement, in this context, is a socially useful and desirable method of determining disputes. We should, therefore, along with other methods of reducing court congestion consider methods to encourage the use of the settlement process. How might we (the Bar, the Courts, the public) encourage settlement, especially pre-litigation settlement? The question is a broad one. For this short article let me pose one idea which perhaps can help stimulate further thinking.

Most of the log-jam of litigation seems to be due to auto accident law suits. (As an aside, we should remember that the best way to reduce court congestion is to reduce auto accidents, but this is probably more an approach for engineers, auto manufacturers, road builders, psychologists and sociologists than lawyers). Most of the

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auto accident litigation is defended by an insurance carrier on behalf of the defendant. What we need to do is to find methods to encourage settlements. We can do this if we make it worthwhile to settle, or potentially more costly not to settle. Consider the idea of using attorneys' fees as the approach.

One of the great difficulties in the settlement process is to get the parties to talk settlement—to make offers and counter-offers. If we can encourage the making of offers, we help the settlement process. Existing California law provides a clue:

(a) A corporation seeking to merge or consolidate must make a fair market value offer to dissenting shareholders for their shares or suffer the burden of paying costs of action if the price offered is insufficient. (§§4304-4313 Corp. Code.)

(b) A defendant, by making an offer in settlement, can shift to the plaintiff costs of litigation thereafter incurred if the judgment is no greater than the offer. (§997 CCP.) There probably are no statistics on the use of this provision. It is doubtless little used and probably has not much effect on settlement. It does not have enough "bite." Costs do not include attorneys' fees. We could give it more "bite" and perhaps make it an effective tool.

A plaintiff injured in an auto accident is entitled, upon recovery, to the financial cost to him of medical help. The theory is that the need for medical aid (the employment of a doctor, etc.) to help restore medical health is a proximate result of the defendant's negligence. Similarly, it is usually necessary for the plaintiff to seek legal help in order to restore himself to his former state of legal and financial health. We might say that the need for legal help (the employment of a lawyer, etc.) to restore legal health is the proximate result of the defendant's negligence. But if the plaintiff were to receive attorneys' fees in every victory, he and his attorney might be discouraged from settlement negotiations. And such a rule would be unfair to a settlement-minded defendant who is willing to offer a fair amount at or before litigation.

Rather, the rule and its corollaries should be: If the defendant makes no offer of settlement, the successful plaintiff is entitled to reasonable attorneys' fees as an element of costs. Where the defendant makes an offer of settlement, the plaintiff's right to fees for his attorneys' services thereafter rendered is cut off, provided the judgment is not greater than the defendant's settlement offer. If

the judgment is greater than the offer, then the court may award reasonable attorneys' fees to the plaintiff.

Consider the consequences of such a rule on the settlement process. The defendant who makes no offer, or makes an insufficient offer, risks additional money—some award to the plaintiff for attorneys' fees. Also, the longer the defendant takes to make his offer (or to revise an offer previously made) the greater risk of incurring additional attorneys' fees because the defendant is cut off from the obligation to pay attorneys' fees only after he makes a sufficient offer.

Probably such a rule would not be popular with plaintiffs' lawyers nor with defense lawyers. Defense lawyers probably will not espouse such a rule because it puts a burden upon them to make settlement offers at the risk of costing their client an additional sum for plaintiff's attorneys' fees. The rule injects a new cost "bite" in the prospective judgment. But maybe claimants' lawyers would like the rule even less. If the plaintiff rejects the offer and his attorney is successful in the litigation, his attorney is then subjected to proof of the "reasonable" value of his services so that his client will receive that additional award. The rule, however, need not limit the amount charged to the plaintiff for services rendered by his attorney, but only determines the amount of the fees the defendant is required to pay.

From the point of view of court congestion, one objection suggests itself. If the plaintiff is successful in obtaining a judgment greater than a settlement offer, an additional hearing might be required to fix a reasonable fee, as is sometimes the case in probate matters where extraordinary fees are claimed. However, a hearing might not be required if mechanical rules, such as apply in cases where a promissory note provides for attorneys' fees, can be established. In any event, such a rule would encourage settlement negotiations and the number of settlements actually made as a result would probably far exceed the number of hearings that might occur under the rule. In all probability such a rule would be a step in the direction of reducing court congestion. And if it satisfies neither claimants' nor defense attorneys, then they ought to be mindful of the greater danger for them (and perhaps for society) if substitutes are legislated for the whole auto accident litigation process we now have. ■

Notes From Your Law Library —

KNOW THY SHELVES!

By JOHN W. HECKEL*

AMERICAN LAW INSTITUTE: The Restatements of the Law, Trusts and Agency, have now been brought out in second editions, 3 volumes each. Austin Scott is the Trusts reporter, while Warren A. Seavey is reporter for Agency.

RECEIVERS: *A Treatise on the Law and Practice of Receivers*, by Ralph E. Clark has been published in a third edition (Cincinnatti, Anderson Co., 1959, 4 v.) It has been expanded, and new material added.

JUDICIAL ADMINISTRATION: Hans Zeisel, Harry Kalvern, Jr., and Bernard Buchholz have co-authored *Delay in the Court* (Boston, Little, Brown, 1959, 313 p.) dealing with court congestion. A result of a University of Chicago Law School study, it discusses the problems of reducing trial time, increasing settlements, and the use of judge's time.

IMMIGRATION: Charles Gordon, Regional Counsel of the Immigration and Naturalization Service, and Harry Rosenfield, Chairman of the ABA Section on Immigration, have written *Immigration Law and Procedure* (Albany, Banks and Co., 1959, 1180 p.). It is in loose-leaf for annual supplementation. The work covers the administrative structure of immigration and nationality, which aliens may enter, procedure, deportation, judicial review, civil liabilities and criminal offenses. An appendix contains specimen forms.

PHILOSOPHY OF LAW: Roscoe Pound's long awaited *Jurisprudence* (St. Paul, West, 1959, 5 v.) is a revision and completion of work he started in 1911. Much of the rewriting was done while he was a Professor at the U.C.L.A. Law School from 1949-1952.

TORTS: *Traffic Victims, Tort Law and Insurance* by Leon Green (Evanston, Northwestern University Press, 1958, 127 p.) is a series of lectures demonstrating that common law jury trial and liability insurance are outmoded as remedies for traffic accidents. The author advocates compulsory motor vehicle comprehensive loss insurance to compensate substantially, if not fully, for traffic losses.

*Head Reference Librarian, Los Angeles County Law Library.

PRICE DISCRIMINATION: *Cost Justification* by Herbert F. Taggart (Ann Arbor, University of Michigan, 1959, 588 p.) reviews the price computations by companies accused of Robinson-Patman Act violations.

TRIALS: A London sensation of 1957 was the acquittal of Dr. Adams on the charges of murdering elderly, wealthy patients after a trial of 17 days. *The Trial of Dr. Adams* by Sybille Bedford (New York, Simon and Schuster, 1959, 245 p.) is a vivid reconstruction of the proceedings by a novelist.

LABOR LAW: Shepard's *Federal Labor Law Citations* (Colorado Springs, 1959, 3 v.) fills a long-felt research need. The new service covers the Decisions of the National Labor Relations Board and the federal courts in labor cases as well as labor provisions in the United States Code.

TRIAL PRACTICE: American Jurisprudence *Proof of Facts* (Bancroft-Whitney, 1959, to be published in 10 v.) is a topical compilation of questions and answers to be used in trial to prove certain facts. There are case citations, comments and annotations to aid in trial preparation.

CURRENT LEGISLATION: An ever-present problem confronting the California Lawyer is where to find the materials to aid in statutory construction, inasmuch as the legislative debates are not published. Several of the important, but not too well known sources, are the reports of the California Law Revision Commission and the reports of legislative interim committees. The Commission was established in 1953 to replace the California Code Commission. Its function is to examine existing law for defects, to consider the work of such organizations as the American Law Institute, and to suggest changes in California law. Recent printed studies, resulting in 1959 legislation, concerned the time within which to move for a new trial, the doctrine of worthier title (based on a study by Prof. H. E. Verrall of UCLA Law School), mortgages to secure future advances, and the time limits for filing tort and other claims against cities and counties and other public entities (based on a study by Prof. Arvo Van Alstyne, also published in 6 U.C.L.A. Law Review, pp. 205-268).

LEGISLATIVE COMMITTEE REPORTS: Many of the interim committee reports may be found in the Journals of the California Legislature whereas some are separately printed. Among the former are those dealing with California anti-trust and unfair practices law (Assembly Journal for April 15, 1959, pp. 2448-2455) and automotive smog control (Assembly Journal of May 5, 1959, pp. 3267-3273). Among the latter are those on state acquisition of abandoned property and recovery by rightful owner (January, 1959, 26 p.), pornographic literature (March, 1959, 45 p.), the state tax structure (May, 1959, 93 p.), and the operation of courts in Los Angeles County (May, 1959, 121 p.).

THE PRESIDENT'S PAGE

(Continued from page 2)

half the time to compose a covenant on ten pages as it would to splatter it over twenty pages—which, admittedly, does not always follow.

In ways other than leisurely litigation and meandering manuscripts lawyers are guilty of squandering time at the clients' expense. Most conferences, both table and telephone, are not clipped as short as they should be. And too much of our correspondence is too verbose.

A scheduled day, as distinguished from a hop, skip and jump day, conserves valuable minutes and over a year will account for a significant increase in the work capacity of hours. Sticking with a chore until completed permits its accomplishment in less time than when it is started, dropped for something else, then picked up again. It is not always possible, of course, for a busy lawyer to avoid interruptions and distractions. Nonetheless, a well planned day will reduce the interruptions and increase the output.

The ascending cost of law is doing our profession no good and, unless curbed, is certain to do serious harm. All of us could well afford to take a periodic inventory of our office procedures and occasionally plumb our legal productivity. Few of us would fail to find room for improvement.

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The View from the Ivory Tower

IS THE SUPREME COURT "SOFT" ON CIVIL LIBERTIES?

By ARVO VAN ALSTYNE*

The average practitioner has regretably little time for reflection on the law's problems and trends other than those with which he is directly concerned. Historically much of such reflection has come from America's law schools. The following article by Professor Van Alstyne initiates a new Bulletin feature: Monthly article by a law school professor on any legal subject he chooses to consider. The Bulletin hopes the series will provide both pleasure and stimulus to reflection for all its readers. —THE EDITOR.

In the current debate between critics of and apologists for the United States Supreme Court, a significant phase of the Court's recent performance has been somewhat obscured. John Frank, in his excellent recent book, "Marble Palace," maintains that the role of the Court in preserving basic freedoms has, on the whole, been slight, and has proved to be more of a ratifying than restraining influence.[1] This viewpoint, if supported by the record, casts an illuminating insight upon the validity of the positions of the present protagonists.

An impressive array of recent decisions—many of which have aroused the ire of the critics—have been only superficially libertarian. To be sure, striking personal victories seem to have been won. In the name of freedom of travel, Kent, Briehl and Dayton overcame the dragon of executive discretion, and secured their passports.[2] Greene upset the industrial security program.[3] Harmon successfully pressed for an honorable discharge from the Army.[4] Sawyer established his right as an attorney to criticize the administration of justice.[5] Peters, Service and Vitarelli vindicated the principle of procedural regularity in the government employee security program.[6] Watkins and Sweezy established limitations upon abuses of witnesses by legislative investigating committees.[7] Slochower gave meaning to the constitutional privilege against self-incrimination.[8] Jencks clarified a criminal defendant's federal discovery rights.[9]

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[1]John P. Frank, Marble Palace, (1958), 195.
[2]Kent and Briehl v. Dulles, 357 U.S. 116 (1958); Dayton v. Dulles, 357 U.S. 144 (1958).
[3]Greene v. McElroy, 360 U.S. 474 (1959).
[4]Harmon v. Brucker, 355 U.S. 579 (1958).
[5]In re Sawyer, 360 U.S. 622 (1959).
[6]Peters v. Hobby, 349 U.S. 331 (1955); Service v. Dulles, 354 U.S. 363 (1957); Vitarelli v. Seaton, 359 U.S. 535 (1959).
[7]Watkins v. United States, 354 U.S. 178 (1957); Sweezy v. New Hampshire, 354 U.S. 234 (1957).
[8]Slochower v. Board of Education, 350 U.S. 551 (1956).
[9]Jencks v. United States, 353 U.S. 657 (1957).

It is characteristic of each of these decisions (and of other like ones which could be cited) that apparently libertarian results were achieved on grounds of statutory interpretation or of procedural irregularity which made unnecessary any consideration of the basic issues of civil liberties at stake. Avoidance of substantive constitutional problems is of course a firmly established and, for the most part, desirable judicial technique. But it scarcely justifies confidence in the continuing vitality of judicial review as a safeguard of basic personal freedoms.

On the other hand, in an equally impressive list of recent decisions, fundamental issues were faced and determined on the merits. Only in rare instances (apart from cases dealing with race relations), however, do the results strengthen individual liberty. Discharge of public employees for refusal to answer questions is constitutionally permissible, despite *Slochower*, if the ground of discharge is euphemistically described as something other than "disloyalty."[10] In the face of massive evidence of improper motivation, legislative committees, despite *Watkins*, are presumed to act solely for valid objectives.[11] Persons suspected of crimes may validly be denied representation by counsel in investigation proceedings.[12] Protection against double jeopardy is meaningless where the same act constitutes a crime under both state and federal law.[13] In spite of the Fifth Amendment, self-incrimination may be compelled by cooperation between state and federal officers.[14] Prosecutions for criminal contempt committed out of court may proceed in federal courts without indictment or jury trial, the Fifth and Sixth Amendments notwithstanding.[15]

The decisions referred to are believed to be a fair sampling of the Supreme Court's recent work. Do they support the view of some critics that the Court has been so deeply engrossed in preserving personal rights, it has failed to give adequate protection to the collective interests of society? Or do they rather document the validity of Alistair Cooke's remark that "liberty is not in our time a markedly American passion"? The debaters would do well to address themselves to the latter question as well as the former.

[10]Lerner v. Casey, 357 U.S. 468 (1958); Beilan v. Board of Education, 357 U.S. 399 (1958).
[11]Barenblatt v. United States, 360 U.S. 109 (1959); Uphaus v. Wyman, 360 U.S. 72 (1959).
[12]Crooker v. California, 357 U.S. 433 (1958); Cicenia v. La Gay, 357 U.S. 504 (1958); In re Groban, 352 U.S. 330 (1957).
[13]Bartkus v. Illinois, 359 U.S. 121 (1959); Abbate v. United States, 359 U.S. 187 (1959).
[14]Knapp v. Schweitzer, 357 U.S. 371 (1958); Mills v. Louisiana, 360 U.S. 230 (1959).
[15]Green v. United States, 356 U.S. 165 (1958).

When is an Offering "Private" Instead of "Public" Under the Securities Act of 1933?

By FRED L. LEYDORF
Second Place Winner
1959 Junior Barristers' Essay Contest

(Continued from the October Issue)

III. Judicial Interpretation

Cases interpreting Section 4(1) of the Securities Act have shown that interpretations by the Securities and Exchange Commission as to what constitutes a "public offering" within the section are entitled to great weight. The courts have also emphasized, however, that they are to have the final say as to whether a transaction is a "private" or "public" offering.

There has been a relatively small number of cases construing this section of the Securities Act. This is undoubtedly due in part to the high degree of care with which the Securities Act as a whole was drafted, but as one writer states it may also be due to "a mutual desire on the part of the financial community and regulatory authorities to work together so as to carry out the basic objectives of the Act."[23] Most of the cases have been decided in favor of the Commission. This is true not only of cases construing this section but of all cases decided under the Securities Act. In all the years of the SEC's existence up to 1955, there were thirty-seven cases in which the Commission was either a party or *amicue curiae* which came before the Supreme Court for decision on the merits. In only six of the cases did the ultimate judgment go against the Commission or the position it espoused.[24] The record in the lower courts was almost as good.

The first case to be decided under Section 4(1) was *Securities and Exchange Commission v. Federal Compress & Warehouse Company*,[25] an unreported case in the Western District of Tennessee in 1936. There the court held that a sale of common stock to stockholders for the purpose of retiring an issue of preferred stock where most of the stockholders were residents of Memphis, was

[23] 19 Brooklyn Law Review 40, supra.
[24] 41 American Bar Association Journal 1137 (1955).
[25] Unreported W. D. Tenn. November 13, 1936, appeal dismissed by consent, 88 F.2d 1018 (1937).

not a "public offering." Stress was laid upon the fact that no advertising or prospectus was issued and there was no machinery for a public distribution, and that the offerees were familiar with the affairs of the company. The Commission soon made known the fact, however, that a solicitation by a corporation of loans from its stockholders might be a public offering if there were a sufficient number of such stockholders.[26]

The first case of real importance to come before the courts was *Securities and Exchange Commission v. Sunbeam Gold Mines Company*.[27] There in 1938 the court held that an offering of securities was a "public offering" although the offering was confined to 530 persons, 115 of whom were stockholders of the offering company, 207 stockholders of another company who sought to become stockholders of the offeror and 208 were stockholders in both companies. In arriving at this decision the court stated that a person claiming to be within the terms of the exception of Section 4(1) has the burden to prove that a public offering was not involved and that this section must be strictly construed against the claimant of its benefit. The case certainly stands for the proposition that an offering to stockholders, other than a very small number, is a public offering.

The next major case to be decided was *Merger Mines Corporation et al. v. Grismer* in 1943.[28] The court found that the provisions of Section 4(1) exempting from registration those transactions by an issuer not involving any public offering did not exempt a proposed offering of a mining company's stock to its 1100 stockholders under a decree providing that if its president accepted new stock in place of stock loaned to the corporation an equal amount of new stock should be offered to other stockholders. In the same year *Corporation Trust Company v. Logan*[29] was decided, the court holding that an "open-end" voting trust agreement for issuance of voting trust certificates in exchange for the stock of a corporation having an authorized capitalization of 5,000,000 shares, of which about 800,000 shares were outstanding among 3500 holders, contemplated the issuance of "securities" in connection with a "public offering" within the Act. Thus it seemed

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[26] *In re Henry Friedlander*, 2 S.E.C. 531 (1937).
[27] 95 F.2d 699 (9th Cir. 1938).
[28] 137 F.2d 335 (9th Cir. 1943), certiorari denied 320 U.S. 794, 88 L.Ed. 478, 64 S.Ct. 261 (1943).
[29] 52 F.Supp. 999 (1943).

that an offering would always be deemed "public" if it was open to a sufficient number of persons.

In 1951 there came a break in the almost solid line of decisions in favor of the Commission. In *Campbell v. Degenther*,[30] a transaction whereby the defendant sold thirty-two shares in the cost of drilling an oil well at a cost of $127.40 per share to persons with whom he became acquainted through mutual business associates, and who were associated with him in drilling other wells, did not involve a "public offering." The court stated that interpretations by the Securities Commission as to what constitutes a "public offering" within this section are entitled to great weight, and went on to talk in its opinion of the four factors given by the General Counsel of the Commission[31] for determining whether an offering is "public" or "private." The court reiterated the statement that an offering of securities under Section 4(1) may be a public offering even though confined to stockholders of an offering company, but then went on to state:

> "By reason of the small number of participants in the venture and their familiarity with each other, I cannot translate the security transactions into a public offering. At most, the transactions herein conducted were a close-knit arrangement among friends and acquaintances on a purely personal basis, without any systematic scheme or promotion program for sale of the said securities to the general public or any select group sufficient in size to fall within the province of a public offering."[32]

Apparently the court felt that since the shareholders had an intimate knowledge of the corporation's affairs, the need for registration just did not exist. In 1953 in *Securities and Exchange Commission v. Searchlight Consolidated Mining & Milling Company*[33] the court flatly held that an offering of securities was a "public offering" even though solicitation was confined to existing stockholders. There the defendants had been selling shares of the common capital stock of the corporation at 10¢ par value per share.

Up to this time the federal courts, while giving lip service to other factors, looked primarily to the number of offerees to which the stock was tendered as the test of what was a "public" or private" offering. Mainly due to the vagueness of the Commission's four factors, however, the courts really did not rely too heavily

[30] 97 F.Supp. 975 (1951).
[31] Sec. Act. Rel. No. 285, supra.
[32] 97 F.Supp. at p. 977.
[33] 112 F.Supp. 726 (1953).

on them as standards for decision. Instead they clung to the prior rules of construction such as (1) putting the burden of proving that a public offering was not involved on the corporation,[34] (2) strictly construing the statute against the corporation,[35] and (3) giving great weight to the SEC determination.[36] This resulted in no tangible guide to reliable decision. As Mr. Irving Mehler has said, "No specific formulae were set forth by any of the judicial tribunals before whom such cases were brought for adjudication."[37] Then the leading case in this entire area of "public" or "private" offering was decided by the U. S. Supreme Court in 1953. This was the case of *Securities and Exchange Commission v. Ralston Purina Company*,[38] which has set the standard for all future cases to follow.

Between 1947 and 1951 the Ralston Purina Company sold without registration nearly $2,000,000 worth of stock to employees of the company residing in many different states, and in so doing made use of the mails. In each of these years a corporate resolution authorized the sale of common stock "to employees . . . who shall, without any solicitation by the Company or its officers or employees, inquire of any of them as to how to purchase common stock of Ralston Purina Company." A memorandum sent to branch and store managers after the resolution was adopted advised that "The only employees to whom this stock will be available will be those who take the initiative and are interested in buying stock at present market prices."

Ralston Purina based its contention that this was a "private offering" on the fact that the offering was not made at random to all of its employees, but was restricted to those considered "key employees" by the company. Both the District Court[39] and the Eighth Circuit Court of Appeals[40] held that the offering was a "private offering" within the exemption of the Act, placing great stress on the fact that the sale of stock by the corporation to its employees was not for the purpose of raising finances, but was to keep part of the stock ownership of the business within the operating personnel of the business and to spread ownership

[34] *S.E.C. v. Sunbeam Gold Mines Co.*, supra.
[35] *S.E.C. v. Sunbeam Gold Mines Co.*, supra.
[36] *Campbell v. Degenther*, supra.
[37] Mehler, "The Securities Act of 1933: 'Private' or 'Public' Offering," 32 Dicta 359 (1955).
[38] 346 U.S. 119, 97 L.Ed. 1494, 73 S.Ct. 981 (1953).
[39] 102 F. Supp. 964 (1952).
[40] 200 F.2d 85 (8th Cir. 1952).

throughout all departments and activities of the business. The Supreme Court reversed, holding that the issue was a "public offering" within Section 4(1).

Mr. Justice Clark, in giving the opinion of the court, stated that "Decisions under comparable exemptions in the English Companies Acts and state 'blue sky' laws . . . have made one thing clear—to be public an offer need not be open to the whole world."[41] He rejected the lower courts' assumption that the reasonableness of selection in relation to the offeror's purpose (to create employee incentive through stock ownership here) was the proper criterion, and went on to point out that among those responding to the company's offers were employees with such duties as those of a bakeshop foreman, chow loading foreman, clerical assistant, stock clerk and production trainee. Instead he stated that the primary purpose of the Securities Act is "to protect investors by promoting full disclosure of information thought necessary to informed investment decision." Therefore the entire selection process must be viewed from the standpoint of the offerees and their protection rather than from that of the issuer and its motives and hopes for

[41] 346 U.S. at p. 123.

gain,[42] and the applicability of Section 4(1) should turn on "whether the particular class of persons affected needs the protection of the Act." The focus of inquiry should be on the need of the offerees for the protection afforded by registration. Thus "An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering.' " Here the employees were not shown to have had access to the kind of information which registration under the Act would disclose, and therefore these transactions were not exempted under Section 4(1) as private offerings.

With regard to the General Counsel's criteria laid down in 1935,[43] Justice Clark indicated that the number of persons to whom the offer is made is not a valid test, quoting Viscount Sumner's dictum with reference to the phrase "offering to the public" which is used in the British definition of "prospectus":

> "The public . . . is of course a general word. No particular numbers are prescribed. Anything from two to infinity may serve; perhaps even one, if he is intended to be the first of a series of subscribers, but makes further proceedings needless by himself subscribing the whole."[44]

Justice Clark saw "no warrant for superimposing a quantity limit on private offerings as a matter of statutory interpretation," but he did say that nothing prevented the Commission from using some kind of numerical test as an administrative guide in deciding when to investigate particular exemption claims. Thus while knowledge of the offerees is the ultimate test, a large number of offerees would appear to be a warning that such knowledge is not present in a particular offering. This seems particularly true in view of Justice Clark's statement that "It may well be that offerings to a substantial number of persons would rarely be exempt."

The Supreme Court's decision has imposed an important limitation on the use of employee stock-investment plans. As one writer states, "Corporations may be reluctant to attempt to put such plans into effect now that this type of offering may involve the expense and delays connected with the Section 5 registration process."[45] And yet in its decision the Supreme Court said that some employee offerings may be exempt. One example the court gives is that an offering limited to executive personnel who because of their po-

[42] 21 University of Chicago Law Review 113, supra.
[43] Sec. Act Rel. No. 285, supra.
[44] *Nash v. Lynde* (1929), A.C. 158.
[45] 21 University of Chicago Law Review 113, supra.

sition have access to the same kind of information that the Act would make available in the form of a registration statement would come within the exemption. This point of view has expressly been taken by statutes in Massachusetts[46] and Indiana.[47] It is almost ironic to point out that the corporation here might have attained its purpose without raising any question as to the exemption under Section 4(1) if a stock bonus had been substituted for the cash bonus from which the employees obtained most of the money used to purchase the stock. Such a transaction would be exempt, since the SEC does not consider a stock bonus to be a "sale" within the meaning of Section 2(3) of the Act.[48]

The Ralston Purina case has evoked widespread and lucid comment. Mr. Irving Mehler says, "A thorny problem had at last received a final adjudication"; and goes on to state flatly that the court laid down four critieria to determine whether the offering is "private" or "public," it being "private" if it comes within these criteria: (1) offering limited to a special class and not to the public generally; (2) purchasers intending to take the shares for investment and not for resale; (3) purchasers having access to the kind of information which a registration statement would disclose; and (4) there being a need of the offerees as a class for protection afforded by registration.[49] This would appear to be a very strained construction, especially in view of the court's own language that "the exemption question turns on knowledge of the offeree."[50] Knowledge of the offerees would seem to be the only rationale given by the court. Many writers do not feel that this case has been such a clear measuring stick, sufficient to solve all problems which may arise in the future:

> "While the Court's decision in the Ralston Purina case should be approved as consistent with the purpose of the Securities Act, it cannot be taken as a solution of all employee-offering problems which may arise. An area in which the effect of the entire complex of facts is all-important can scarcely be susceptible to comprehensive self-executing regulation. Desirable as certainty may be, each case will in large

[46]Massachusetts Annotated Laws (1958) c. 110A, Sec. 11E.
[47]Indiana Statutes Annotated (Burns, Supp., 1957), Sec. 25-833(n).
[48]66 Harvard Law Review 1144 (1953).
[49]32 Dicta 359, supra.
[50]346 U.S. at p. 126.

measure create its own rule, with the over-all purpose of the Act as the prinicpal guide."[51]

"... the court's ultimate standard seems to be one not strictly called for by the language of the Act. The result in a given case now depends primarily on whether or not the court decides that the offerees are in need of the information which is required to be supplied in connection with registration. This bears no particular relation to the question of whether there is an offer to the general public."[52]

Mr. Louis Loss, perhaps the leading writer in the over-all field of security regulation, states that "On the pragmatic rather than the semantic level ... the Supreme Court's opinion will probably have little effect on the traditional position taken by the Commission except to strengthen it."[53] Other writers express doubts:

"The scope of the exemption afforded by Section 4(1) has been more accurately defined as a result of this decision. However, the question still remains whether an offer made to a limited number of offerees, not shown to have had access to information which a registration statement would disclose, would still be a private offering. The possibility still exists that an unregistered offer, made to but one offeree who did not have access to knowledge, would be considered a violation of Section 5 of the Securities Act."[54]

[51] 21 University of Chicago Law Review 113, Supra.
[52] 52 Michigan Law Review 298, supra.
[53] Loss, *Securities Regulation*, supra.
[54] 4 Catholic University Law Review 70 (1954).

And yet other writers are expansive in their praise:

> "The recognition of such a controlling test on the non-public offering question by the Supreme Court is commendable. To require disclosure of pertinent facts related to a stock issue whenever the offeree is deficient in first-hand information concerning the offering is clearly to conform to statutory purpose."[55]
>
> "By applying the new test of whether the offerees are well-enough informed to dispense with the requirement of registration, the court has taken a long step toward the fulfillment of the obvious intent of the Act—that of protecting the public investors. . . . The result of such an interpretation by the Supreme Court is the more effective judicial administration of the Act and a more realistic approach to the problem of dispensing information to the investing public."[56]

Only a very few cases have come down since the Ralston Purina case, none of them Supreme Court decisions. One merely reiterated the proposition that the burden of proof of an exemption from registration is upon the issuer,[57] while another merely said the complete factual situation had not been developed and sent the case back to the District Court, noting that full consideration of all facts was necessary to determine whether the plaintiffs fell within the class of investors the statute is designed to protect under the Ralston Purina case.[58] A third case was *Zweifach v. Scranton Lace Company*.[59] There a transaction whereby a lace corporation assigned, transferred, and delivered all of its remaining authorized but unissued no par value common stock and certain treasury stock in exchange for all of the issued and outstanding capital stock of another corporation was not a "public offering" and therefore not subject to the Securities Act. The case merely cited the Ralston Purina case and *Campbell v. Degenther* without further explanation. These cases offer nothing new in determining when an offering is "private" or "public," but they do indicate a close adherence to the standard laid down in the Ralston Purina case. An even closer adherence to that standard has since been given by the Supreme Court of Colorado[60] when it said: "The real test is—whether the particular class of persons affected need the information made available by registration."

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[55] 48 Northwestern University Law Review 771 (1954).
[56] 3 Utah Law Review 519 (1953).
395 (1957).
[57] *Securities and Exchange Commission v. Franklin Atlas Corporation*, 154 F.Supp. 395 (1957).
[58] *Knapp v. Kinsey*, 249 F.2d 797 (1957).
[59] 156 F.Supp. 384 (1957).
[60] *Central Bank & Trust Company v. Robinson*, 137 Colo. 409 (1958).

The requirement that securities must be registered before being offered for sale applies primarily to public offerings of newly issued securities. But problems of secondary distribution may also arise when the new offering also includes a resale of securities already issued and outstanding. The application of the registration provisions of the Act frequently is required in this situation also.[61] This point was under consideration in *Securities and Exchange Commission v. Mono-Kearsarge Consolidated Mining Company*,[62] decided in October 1958. There it was held that where a company transferred stock to persons, however limited in number or well informed, who did not intend to treat it as investment stock but who claimed the right of immediate redistribution to the public and who actually made such redistribution, and the company had knowledge of this or was acting under circumstances reasonably placing it on notice, there was a "sale" of securities within the registration requirements of the Securities Act and there was a public offering of the stock.

This same conclusion has also recently been reached in a series of cases before the SEC where the Commission determined that since the original purchasers intended to resell and the issuer knew or reasonably should have known of the purchasers' intentions, a private-offering exemption was not available to the issuer. Also even if the old "number of offerees" test were still applicable after the Ralston case, the number of offerees was not limited to the first purchasers but included the total number of purchasers and

[61]For a recent article on secondary distribution problems see Modesitt, "Secondary Distributions of Securities," 34 Dicta 156 (1957).

[62]167 F.Supp. 248 (1958).

subpurchasers in the entire sale operation.[63] And it must be constantly borne in mind that the exemptions provided for in Section 4 relate only to the registration requirements, so that the fraud provisions of the Act are fully applicable to any of the transactions exempted under Section 4 such as a private sale.[64]

Mr. Louis Loss states that under the private offering exemption, taking the calendar year 1952 as an example, over $4 billion of corporate securities were issued without registration. Almost all of the securities privately placed have been bonds and the proportion of these bonds taken by life insurance companies has averaged around ninety per cent. Mr. Loss goes on to state:

> "The development of the phenomenon (of private placements) more or less coincides with the life of the Securities Act, but there are so many other facts which explain the growth of private placements that it seems permissable to infer that the effect of the Securities Act has been relatively minor, and that the incidence of private placements would not be substantially affected if the Act were to be repealed altogether."[65]

IV. Conclusion

Generally speaking Section 4(1) of the Securities Act has proved to be workable over the past twenty-five years. Despite the lack of a very meaningful legislative history, the total lack of amendment and relatively few number of cases decided under it testify to the care of its drafting and relative clarity of its interpretation. However, it does not clearly set forth a solution to the basic problem of how many persons may be approached to buy stock in a corporation without the transaction being considered a "public offering." The "needs" test advocated by the Ralston Purina case, in which the basic consideration is whether in a given case the particular offerees need the protection which Congress intended they should have, is a great step toward effectuating the intent of Congress to protect public investors. But it still comes far from showing when an offering is "private" instead of "public" under the Securities Act. The only assurance of having a private sale would appear to be to make certain that all offerees were completely and fully informed about all the corporation's affairs, and to try to have the offerees be as few in number as possible. And yet since each case presents a separate factual matter,

[63] 72 Harvard Law Review 784, supra.
[64] *Northern Trust Company v. Essaness Theatres Corporation*, 103 F.Supp. 954 (1952).
[65] Loss, *Securities Regulation*, supra, at p. 401.

it is impossible to say whether the court in any given situation would find complete knowledge of the corporate affairs on the part of each offeree. The only guide which could possibly be given was set forth in the Ralston Purina case to the effect that each set of factual circumstances must be decided against a backdrop of the overriding purpose of the Securities Act as a whole—to protect public investors by "full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof . . ."[66] As one writer has so aptly stated in regards to the Ralston Purina case, "It is only by such a liberal reading of the statutory terms that the courts have succeeded in giving proper recognition to social and economic needs for which the legislature has not expressly provided."[67] ■

[66]Preamble to the Securities Act, 48 Stat. 74, supra.
[67]52 Michigan Law Review 298, supra.

TAX REMINDER

WILLS AND PRORATION OF ESTATE TAXES

By A. R. KIMBROUGH*

Every lawyer has heard about the testator who remembered his faithful retainers and worthy charities handsomely and thereby unintentionally disinherited his residuary beneficiaries. In the original story the estate was reduced by economic misfortunes. Today if it were not for our apportionment statute, similar injustices would result solely because the estate tax collector is the distributee of a major share of each substantial estate. The law provides that unless the decedent has otherwise directed, the burden of the federal death tax will be spread proportionately among the taxable distributees.

When the Revenue Act of 1926[1] set the maximum tax bracket at twenty per cent, only those in financial centers such as New York were concerned. There Section 124 of the Decedent Estate Law[2] was the first statute requiring the sharing of the federal tax on an equitable basis. The times and the rates changed, however, and by 1935 the maximum bracket was seventy per cent.[3] Then the rules governing the sharing of this capital levy became important to all testators and their lawyers.

The basic ground rules were settled by 1942. The Supreme Court then said that while the executor must pay the tax out of the estate, its impact was to be determined by local law.[4] While that litigation plodded to a conclusion, the maximum tax bracket inched upward to seventy-seven per cent.[5] By 1943 ten states including California had enacted legislation providing for apportionment of federal estate taxes.

The California law is found in sections 970 to 977 inclusive of the Probate Code.[6] Since the law permits prospective decedents to state how the tax should be borne, the most important element for consideration here is an analysis of the actions which may and should take place before death. Under the ideal plan the testator

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[1]Sec. 301, Pub. Law No. 20, 69th Cong.
[2]New York, Consolidated Laws, Chap. 13 (Chap. 709, Laws of 1930).
[3]Sec. 201, Revenue Act of 1935, Pub. Law No. 407, 74th Cong.
[4]*Riggs v. Del Drago* (1942) 317 U.S. 95, 63 S. Ct. 109.
[5]Sec. 935(b) Internal Revenue Code of 1939, Sec. 401(a) Revenue Act of 1941.
[6]Cal Stats. 1943, Ch. 894, sec. 1, p. 2740. Twenty other states now have comparable statutes.

will first determine approximately what each distributee should have after taxes. He will then parcel out the available assets and direct the payment of taxes in the manner which accomplishes his desires. Many assets such as life insurance and joint tenancy property are not a part of the probate estate. The tax, however, is initially payable from the assets subject to administration. The law requires beneficiaries of insurance, surviving joint tenants and others receiving taxable amounts outside of probate to repay to the probate estate an equitable share of the tax on these benefits. If the law reaches the result intended by the testator nothing further need be done. On the other hand any modifications deemed desirable may be made by appropriate language in the will.[7]

One of the most serious problems under these statutes has been to construe and apply language dealing in an ambiguous or uncertain way with the sharing of the tax burden. A common illustration is provided by the *Estate of Pearson*[8] where a direction to deliver realty "free and clear of all liens of any kind" was finally held in the appellate court to mean that no tax could be apportioned to the share of this devisee. Another circumstance productive of litigation in the past arises when the testator directs that death taxes are to be paid out of the residue of his estate, and at the same time indicates that the devises and bequests in the will are to be delivered free of tax. The court must determine whether or not the general direction is limited by the specific instruction. It was held in *Estate of Moore*[9] that only the legatees mentioned in the will were absolved from taxation and the property passing outside the will must bear its equitable share of the estate tax.

The goal in all cases is to plan the estate and draft the will to cause the taxes to be paid by the persons and in the manner which the testator selects. If he decides that the taxes on all interests should be paid from the residue of the estate, there of course are many ways in which this result may be accomplished. It is suggested, however, that in most cases the following language would be satisfactory:

> "I direct the payment of all estate and inheritance taxes due by reason of my death out of the residue of my estate. No such tax shall be prorated or apportioned." ■

[7]Note also that in proper cases a written direction respecting apportionment may also be executed inter vivos. Probate Code Section 970.
[8](1949) 90 CA (2d) 436, 203 P. (2d) 52.
[9](1958) 165 CA (2d) 455, 332 P. (2d) 108.

Brothers-In-Law

By George Harnagel, Jr.

GEORGE HARNAGEL, JR.

A Gift Horse should not be Looked in the Mouth. Nor, according to a College Roommate of Fond Memory, should a Good Story be Scrutinized in the Facts.

Ordinarily I Observe both of those Canons of Conduct, reserving, however, the Privilege of Occasional Deviation. An Occasion recently Occurred on which I Violated both, at One and the Same Time.

An Old Friend, who would probably prefer to remain Anonymous, sent me an Item which he thought might be Suitable for use in this Sedate Column. It purported to be a Copy of the Last Will and Testament of one Herman Oberweiss and carried a Notation to the Effect that it was in his Own Handwriting and had been Offered for Probate at the June, 1934, Term of County Court, Anderson County, Texas. I Detected about it, or so I thought, the Odor of Contrivance and, responding to a Stray Impulse, decided to investigate.

First, I asked my Old Friend if he could Vouch for its Authenticity. To this he Responded in True Lawyer-Like Fashion—for he is One of Us—by saying that he neither Affirmed nor Denied its Validity; and that all he Knew about it was that it had been Handed to him by an Associate who had Discovered it in the Course of Cleaning out an Old Desk which had not been Policed for some Ten Years, more or less. Having some Doubt that this was Sufficient to Establish Authenticity under the Ancient Document Rule, I pursued my Investigation.

Next I turned to an Atlas which I regarded as Trustworthy and Found that there was Indeed an Anderson County in the State of Texas, my Confidence in the Reliability of my Source Book being shaken only Momentarily by its Disclosure that the County Seat bore the rather Improbable Name of Palestine. Research in a Usually Reliable Legal Directory confirmed the Intelligence that the County Court of Anderson County sits at Palestine and that it possesses Probate Jurisdiction.

A Letter was then Directed to the Clerk of that Court which Enclosed a Copy of the Questioned Document and Inquired whether it had in Fact been Tendered for Probate and, if so, whether it had been Admitted to that Status. To which the following Prompt and Succinct Reply was received:

> Dear Sir:
>
> We have no such thing as the above. We have requests for this from all over the world, just how and where it originated we don't know.

With that Background I tender below a Slightly Expurgated Version of the Seemingly Spurious

LAST WILL AND TESTAMENT OF HERMAN OBERWEISS

I AM WRITING MY WILL MINESELF THAT THE LAWYIR WANT HE SHOULD HAVE TO MUCH MONEY. HE ASK TO MANY ANSWERS ABOUT THE FAMILY.

FIRST THING I WANT DONE I DON'T WANT MY BROTHER OSCAR TO GET A DAM THING. I GOT HE IS A MISER, HE DONE ME OUT OF FOUR DOLLARS FORETEEN YEARS SINCE.

I WANT IT THAT HILDA MY SISTER SHE GETS THE NORTH SIXTIE AKERS OF IT WHERE I AM HOMING IT NOW. I BET SHE DON'T GET THAT LOAFTER HUSBAND OF HERS TO BRAKE TWENTY AKERS NEXT PLOWING. SHE CAN'T HAVE IT IF SHE LETS OSCAR LIVE ON IT. I WANT IT I SHOULD HAVE IT BACK IF SHE DOES.

TELL MAMA THAT SIX HUNDRET DOLLARS SHE HAS BEEN LOOKING FOR TEN YEARS IS BERRIED FROM THE BAKHOUSE BEHIND ABOUT TEN FEET DOWN. SHE BETTER LET LITTLE FREDERICK DO THE DIGGING AND COUNT IT WHEN HE COMES UP.

PASTOR LICKNITZ CAN HAVE THREE HUNDRET DOLLARS IF HE KISSES THE BOOK HE WONT PREACH NO MORE DUMHEAD TALKS ABUT POLITIKS. HE SHOULD A ROOF PUT ON THE MEETING HOUSE WITH IT AND THE ELDERS SHOULD THE BILLS LOOK AT.

MAMA SHOULD THE REST GET, BUT I WANT IT SO THAT ADOLPH SHOULD TELL HER WHAT NOT SHE SHOULD DO SO NO MORE

SLICK IRISHERS SELL HER VAKEM CLEANER. THEY NOISE LIKE HELL AND A BROOM DON'T COST SO MUCH.

I WANT IT THAT MINE BROTHER ADOLPH BE MY EXECUTOR AND I WANT IT THAT THE JUDGE SHOULD PLEASE MAKE ADOLPH PLENTY BOND PUT UP AND WATCH HIM LIKE HELL. ADOLPH IS A GOOD BUSINESS MAN BUT ONLY A DUMKOPH WOULD TRUST HIM WITH A BUSTED PFENNIG.

I WANT DAM SURE THAT SCHLEIMEL OSCAR DON'T NOTHING GET. TELL ADOLPH HE CAN HAVE A HUNDRET DOLLARS IF HE PROVE TO JUDGE OSCAR DON'T GET NOTHING. THAT DAM SURE FIX OSCAR.

(signed) HERMAN OBERWEISS

Postscript: I am sorry that it turned out that way and I hope that the exposure of this literary fraud will not chill the impulse which any reader of this department might otherwise have to share with it any legal gem, pseudo or otherwise, which he may be harboring. As I have tried to indicate, ordinarily I do not peer into the oral cavity of a donated equine.

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Reasonable Doubt

"Reasonable doubt is the doubt of a reasonable man. When the reason, like a bird flying over the sea, looks in vain for a substantial object on which to rest and fold its wings of perplexity, it can be said that the mind is in a state of reasonable doubt."—Musmanno, J., in *Commonwealth v. Clinton,* 391 Pa. 212, at p. 219.